until the end of the transition period.[495]

193. We note that we already have an interim intercarrier compensation regime for ISP-bound traffic, and to avoid disruption in the marketplace, we will apply on a transitional basis the pricing standards we adopted for ISP-bound traffic in the *ISP Remand Order*,[496] as modified by the *Core Forbearance Order*.[497] Currently, two rules remain in effect: (1) ISP-bound traffic is currently subject to a reciprocal compensation rate cap of $.0007 per minute-of-use; and (2) under the mirroring rule, the $.0007 cap applies to traffic exchanged with an incumbent LEC only if it offers to exchange all traffic subject to section 251(b)(5) at the same rate. As explained below, we conclude that it is appropriate to retain these rules, but only on a transitional basis until a state commission, applying the "additional costs" standards adopted in this order, has established reciprocal compensation rates that are at or below $.0007 per minute-of-use.

194. In the *ISP Remand Order* in 2001, based on "convincing evidence in the record" that carriers had "targeted ISPs as customers merely to take advantage of . . . intercarrier payments"—offering free service to ISPs, paying ISPs to be their customers, and sometimes engaging in outright fraud—the Commission adopted an interim ISP payment regime to "limit, if not end, the opportunity for regulatory arbitrage."[498] The Commission adopted a gradually declining cap on intercarrier compensation for ISP-bound traffic, beginning at $.0015 per minute-of-use and declining to $.0007 per minute-of-use.[499] These rate caps reflected the downward trend in intercarrier compensation rates contained in then-recently negotiated interconnection agreements.[500] We have previously recognized that evidence that "carriers have agreed to rates"—through voluntary, arms-length negotiations—constitutes substantial evidence that rates are just and reasonable.[501]

[495] Consistent with our conclusion that CMRS providers are unable to assess access charges during the transition, we make clear that our symmetry rule, set forth in Part V.C.1.b, will not apply until the transition is over. Even so, we clarify that, to the extent that any carrier has a terminating rate above the permissible rate, such carrier must reduce the rate to the permissible level. Specifically, in the first year of the transition, all carriers with intrastate access charges higher than their interstate access charges must reduce such charges by 50 percent of the difference between its interstate switched access rate and its intrastate switched access rate. Similarly, once the state-set interim, uniform rate is in effect, all carriers must reduce terminating rates, whether interstate access, reciprocal compensation, or ISP-bound traffic, by 50 percent of the difference between the current terminating switched access rate and the interim, uniform rate (as it is reduced over time). Even though rates during the transition will not reflect true symmetry, rates for most carriers should be symmetric before the transition is over as all carriers reduce charges to the final, uniform rate.

[496] *See ISP Remand Order*, 16 FCC Rcd at 9153, 9186–93, paras. 21, 77–88.

[497] *See Core Forbearance Order*, 19 FCC Rcd at 20184–89, paras. 16–26.

[498] *ISP Remand Order*, 16 FCC Rcd at 9187, para. 77.

[499] *ISP Remand Order*, 16 FCC Rcd at 9187, para. 78.

[500] *ISP Remand Order*, 16 FCC Rcd at 9190–91, para. 85.

[501] *ISP Remand Order*, 16 FCC Rcd at 9190–91, para. 85; *see also Petition of ACS of Anchorage, Inc. Pursuant to Section 10 of the Communications Act of 1934, as Amended, for Forbearance from Sections 251(c)(3) and 252(d)(1) in the Anchorage Study Area*, WC Docket No. 05-281, 22 FCC Rcd 1958, 1984–85, paras. 39, 40 n.136 (2007) (finding that "commercially negotiated rates" provide "just and reasonable prices"); *Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers; Implementation of the Local Competition Provisions of the Telecommunications Act of 1996; Deployment of Wireline Services Offering Advanced Telecommunications Capability*, CC Docket Nos. 01-338, 98-147, 96-98, Report and Order and Order on Remand and Further Notice of Proposed Rulemaking, 18 FCC Rcd 16978, 17389, para. 664 (2003) (subsequent history (continued....)

195. Most commenters urge the Commission to maintain the interim compensation rules governing ISP-bound traffic until the Commission is able to transition to comprehensive intercarrier compensation reform.[502] These parties contend that a higher compensation rate would create new opportunities for arbitrage[503] and impose substantial financial burdens on wireless companies, incumbent LECs and state public utility commissions.[504] They further claim that the existing regime has simplified interconnection negotiations.[505]

196. We share these commenters' concerns. The record also suggests that eliminating the $.0007 cap and instead applying higher reciprocal compensation rates that may be set by the states during the transition period to the adoption of our new methodology would have a significant negative impact on

(continued from previous page) omitted) (*Triennial Review Order*) (finding that "arms-length agreements . . . to provide [an] element at [a] rate" "demonstrate[s]" that the rate is "just and reasonable").

[502] *See, e.g.*, Letter from Gregory J. Vogt, Counsel for CenturyTel, Inc. to Marlene H. Dortch, Secretary, FCC, WC Docket No. 05-337, CC Docket Nos. 96-45, 01-92, Attach. at 10 (filed July 8, 2008) (asking the Commission to maintain the existing compromises reached with respect to ISP-bound traffic); Letter from Gary L. Phillips, Associate General Counsel, AT&T, to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 01-92, 96-98, 99-68 at 8 (filed May 9, 2008) (asserting that the public interest would be best served by maintaining the existing transitional rates pending broader intercarrier compensation reform); Letter from L. Charles Keller, Counsel for Sage Telecom, to Marlene H. Dortch, Secretary, FCC, WC Docket Nos. 99-68, 01-92, Attach. at 6 (Sage Telecom May 9, 2008 *Ex Parte* Letter) (stating that retaining the ISP rate serves broad policy goals); Letter from John T. Nakahata, Counsel for Level 3 Communications, to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 01-92, 99-68 at 1 (filed May 7, 2008) (supporting continuation of the interim compensation rules); Letter from Joshua Seidmann, Vice President of Regulatory Affairs, ITTA, to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 99-68, 96-98, Attach. at 2 (filed Apr. 28, 2008) (ITTA Apr. 28, 2008 *Ex Parte* Letter) (asking the Commission to retain the current $0.0007 rate for ISP-bound traffic); Letter from Donna Epps, Vice President of Federal Regulatory Affairs, Verizon, to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 99-68, 96-98 at 1 (filed Apr. 7, 2008) (urging the Commission to support its earlier finding that $0.0007 is appropriate compensation for dial-up ISP traffic); Letter from L. Charles Keller, Counsel for Verizon Wireless, to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 01-92, 99-68, Attach. (filed May 1, 2008) (describing how elimination of the existing ISP rate would create substantial burdens on a number of carriers and state commissions) (Verizon Wireless May 1, 2008 *Ex Parte* Letter); Letter from Glenn Reynolds, Vice President, Policy, USTelecom, to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 01-92, 99-68, 96-262, WC Docket No. 07-135 at 2 (filed Apr. 29, 2008) (noting that the Commission's existing rules have "largely mitigated the debate around compensation for ISP-bound traffic, but there is every reason to believe the same problems would arise if the Commission were to reverse direction on this issue") (USTelecom Apr. 29, 2008 *Ex Parte* Letter).

[503] *See, e.g.*, USTelecom Apr. 29, 2008 *Ex Parte* Letter at 2; Letter from Melissa E. Newman, Vice President, Federal Regulatory, Qwest, to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 99-68, 96-98, WC Docket No. 07-135, Attach. at 3–5 (filed Apr. 25, 2008) (Qwest April 25, 2008 *Ex Parte* Letter); Verizon and BellSouth, Further Supplemental White Paper on ISP Reciprocal Compensation at 20 (Verizon/BellSouth Further Supp. ISP White Paper), *attached to* Letter from Donna Epps, Vice President, Federal Regulatory Advocacy, Verizon, to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 96-98, 99-68 (filed Sept. 27, 2004).

[504] *See, e g.*, Verizon Wireless May 1, 2008 *Ex Parte* Letter, Attach.

[505] *See, e.g.*, Verizon Wireless May 1, 2008 *Ex Parte* Letter (stating that "the [m]irroring [r]ule simplified wireless-ILEC interconnection negotiations tremendously."); Supplemental Comments of Verizon and Verizon Wireless on Intercarrier Payments for ISP-Bound Traffic and the *WorldCom* Remand, CC Docket Nos. 01-92, 96-98, 99-68 at 38–40 (filed Oct. 2, 2008) (Verizon/Verizon Wireless Oct. 2, 2008 Supp. Comments) (indicating that Verizon entered into multiple agreements using the $.0007 rate cap established in the *ISP Remand Order*).

carriers serving rural markets and broadband deployment.[506] The record demonstrates that dial-up minutes remain at high levels in rural areas and that the application of reciprocal compensation to these minutes would generate significant costs to carriers serving these rural areas.[507] Thus, it remains the case that the "rate caps help avoid arbitrage and market distortions that otherwise would result from the availability of reciprocal compensation for ISP-bound traffic."[508] We further believe that maintaining the cap on a transitional basis will minimize the disruptive effects and regulatory uncertainty that otherwise would result from the abrupt elimination of clear compensation rules for ISP-bound traffic.

197. We expect that state commissions, applying the new "additional costs" standard adopted in this order, will set final reciprocal compensation rates at or below $.0007 per minute-of-use. As noted below, the evidence in the record suggests that the incremental cost of call termination on modern switches is de minimis.[509] We have given state commissions up to ten years to transition to new rates based on the "additional costs" standard. Accordingly, the rate cap will only have an impact in a particular state on a transitional basis until that state sets rates at or below $.0007.

198. The mirroring rule has also succeeded in promoting the Commission's "goal of a more unified intercarrier compensation regime by requiring LECs to offer similar rates for like traffic."[510] Most intraMTA traffic is now exchanged pursuant to the rate caps, and a substantial portion of wireline intraexchange traffic is being exchanged at rates at or below the rate caps as well.[511] Eliminating the mirroring rule and allowing carriers to charge higher transitional reciprocal compensation rates for traffic currently subject to the mirroring rule would significantly increase the cost carriers incur in exchanging that traffic. Those increased costs would divert funds from investment in next generation wireless networks and likely would be borne by consumers, through increases in the costs of wireless offerings.[512]

199. We reject arguments that the Commission unlawfully delegated its authority in the *ISP Remand Order* and arguments that the Commission addressed previously in the *Core Forbearance*

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[506] *See, e.g.*, ITTA April 28, 2008 *Ex Parte* Letter, Attach. at 3, 5; Embarq May 1, 2008 *Ex Parte* Letter, Attach. at 2, 5–7.

[507] *See, e.g.*, Letter from Tamar E. Finn, Counsel for Earthlink, to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 99-68, 01-92, Attach. at iii, 11–12 (filed Aug. 14, 2008) (estimating that 24% of dial-up users in rural America say that broadband service is not available where they live); Sage Telecom May 9, 2008 *Ex Parte* Letter at 3–4; Embarq May 1, 2008 *Ex Parte* Letter, Attach. at 6 (calculating its cost to be $100 million if all ISP-bound minutes were subject to TELRIC-based rates under section 251(b)(5)); ITTA Apr. 28, 2008 *Ex Parte* Letter (noting that dial-up usage remains strong in rural areas); USTelecom Apr. 29, 2008 *Ex Parte* Letter (noting a "recent study from the Pew Internet & American Life Project that indicated that while the number of dial-up subscribers had dropped 63% since 2001, the number of minutes spent online by each dial-up subscriber had increased approximately 70%. As a result, some USTelecom member companies are actually seeing an *increase* in dial-up minutes.") (emphasis in original); Letter from Bennett L. Ross, General Counsel—D.C., BellSouth D.C., to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 01-92, 99-68, WC Docket No. 03-171 (filed Aug. 29, 2005) (attaching a chart showing that "dial-up subscribers would continue to generate substantial minutes of dial-up ISP calls, notwithstanding projections of a continued decline in the number of dial-up subscribers.").

[508] *Core Forbearance Order*, 19 FCC Rcd at 20815–16, para. 18.

[509] *See infra* para. 250.

[510] *Core Forbearance Order*, 19 FCC Rcd at 20816, para. 19.

[511] *See, e.g.*, Verizon/Verizon Wireless Oct. 2, 2008 Supp. Comments at 40.

[512] Verizon/Verizon Wireless Oct. 2, 2008 Supp. Comments. at 40.

Order.[513] We also disagree with parties who suggest that the Commission, in responding to the D.C. Circuit's remand in *WorldCom*, must offer detailed new justifications for each of the four features of the ISP intercarrier payment regime: the rate caps, the mirroring rule, the growth cap, and the new markets rule.[514] The prior policy justifications offered for those rules by the Commission have not been overturned by any court, and our current policy justification for retaining these rules is simply to maintain the status quo in this area on a transitional basis until our new "additional costs" methodology has been fully implemented. Indeed, pursuant to our new "additional costs" methodology, we believe that the rate caps set forth in 2001 may well be higher than the final, uniform reciprocal compensation rates set by the states. However, discarding these rules during the transition to our new methodology would be unwise and unwarranted because the "rate caps are necessary to prevent discrimination *between* dial-up Internet access customers and basic telephone service customers," those caps "protect consumers of basic telephone service" from being forced to subsidize dial-up Internet access service, and the rate caps minimize the "classic regulatory arbitrage" that reciprocal compensation for ISP-bound traffic had made possible.[515]

200. In sum, we maintain the $.0007 cap and the mirroring rule, on a transitional basis, pursuant to our section 201 authority. These interim rules shall remain in place in a state until the state commission, applying the "additional costs" standard adopted in this order, has established reciprocal compensation rates that are at or below $.0007 per minute-of-use.

201. We find that our transition plan is necessary and appropriate to prevent undue economic hardships to carriers caused by a too-rapid reduction in intercarrier compensation rates. If there is evidence that carriers are attempting to abuse the interim, uniform reciprocal compensation rate and/or transition process to create arbitrage opportunities, we encourage carriers to bring such evidence to our attention or that of the state commission so such claims can be investigated and, if appropriate, action taken.

3. Legal Authority

a. Legal Authority for Comprehensive Reform—Interpretation of Sections 251(b)(5) and 251(g)

202. The history of intercarrier compensation reveals many policy reasons for comprehensively reforming intercarrier compensation rates, including reducing arbitrage, promoting competition, facilitating the introduction of new technologies, and benefiting consumers. The dual structure of separate federal and state jurisdiction over communications has made accomplishing such reforms more complex, however. Although our reform does not disturb those fundamental jurisdictional distinctions, we find that, through the tools made available by the 1996 Act, we have the means to accomplish this reform by electing to partner with the states.

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513 *See* Letter from Michael B. Hazzard, Counsel for Core Communications, to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 99-68, 01-92, Attach. at 18 & n.8 (filed May 14, 2008) (Core May 14, 2008 *Ex Parte* Letter). We also reject Core's argument that the *ISP Remand Order* unlawfully delegates to incumbent LECs the decision of whether the *ISP Remand Order* applies. *See id.* at 19–20. The Commission did not delegate its authority in the *ISP Remand Order* but rather provided options that were not mandatory. *See, e.g.*, *ISP Remand Order*, 16 FCC Rcd at 9193, para. 89. Additionally, Core argues that the Commission provided no reasoned explanation for the growth cap and new market rules adopted in the *ISP Remand Order* and never provided notice or an opportunity for comment on those specific rules. These rules, as applicable to all carriers, were forborne from in the *Core Forbearance Order*. *See Core Forbearance Order*, 19 FCC Rcd at 20186–87, paras. 20–21. As such, this argument is moot.

514 *See* Core May 14, 2008 *Ex Parte* Letter, Attach. at 20–26.

515 *In re Core Commc'ns* 455 F.3d at 277–80 (internal quotation marks omitted).

203. The Commission unquestionably has authority to reform intercarrier compensation with respect to interstate access services, rates charged by CMRS providers, and IP/PSTN traffic. Section 2(a) of the Act establishes the Commission's jurisdiction over interstate services, for which the Commission ensures just, reasonable, and not unjustly and unreasonably discriminatory rates under section 201 and 202.[516] Likewise, the Commission has authority over the rates of CMRS providers pursuant to section 332 of the Act.[517] We also make clear that authority to impose economic regulation with respect to IP/PSTN traffic rests exclusively with this Commission. The Commission has adopted a number of regulatory requirements applicable to interconnected VoIP services and providers.[518] With respect to the statutory classification of IP-enabled services, however, the Commission only has addressed two situations.[519]

204. We now classify as "information services" those services that originate calls on IP networks and terminate them on circuit-switched networks, or conversely that originate calls on circuit-switched networks and terminate them on IP networks (collectively "IP/PSTN" services).[520] Such traffic

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[516] 47 U.S.C. §§ 152(a), 201, 202.

[517] 47 U.S.C. § 332.

[518] *See, e.g., Telephone Number Requirements for IP-Enabled Services Providers; Local Number Portability Porting Interval and Validation Requirements; IP-Enabled Services; CTIA Petitions for Declaratory Ruling on Wireline-Wireless Porting Issues*, CC Docket Nos. 99-200, 95-116, WC Docket Nos. 07-243, 07-244, 04-36, Report and Order, Declaratory Ruling, Order on Remand, and Notice of Proposed Rulemaking, 22 FCC Rcd 19531, 19538–40, paras. 14, 16 (2008) (*LNP Order*) (imposing LNP requirements, and noting that the Commission previously imposed the requirement to provide 911 service, to contribute to universal service, to protect the privacy of customers, to comply with disability access and telecommunications relay service requirements, and to satisfy certain CALEA obligations).

[519] On one hand, the Commission classified as an "information service" Pulver.com's free service that did not provide transmission and offers a number of computing capabilities. *Petition for Declaratory Ruling that Pulver.com's Free World Dialup is Neither Telecommunications nor a Telecommunications Service*, WC Docket No. 03-45, Memorandum Order and Opinion, 19 FCC Rcd 3307 (2004) (*Pulver.com Order*). On the other hand, the Commission found that certain "IP-in-the-middle" services were "telecommunications services" where they: : (1) use ordinary customer premises equipment (CPE) with no enhanced functionality; (2) originate and terminate on the public switched telephone network (PSTN); and (3) undergo no net protocol conversion and provide no enhanced functionality to end users due to the provider's use of IP technology. *See, e.g., Petition for Declaratory Ruling that AT&T's Phone-to-Phone IP Telephony Services are Exempt from Access Charges*, WC Docket No. 02-361, Order, 19 FCC Rcd 7457 (2004) (*IP-in-the-Middle Order*). *See also, e.g., Regulation of Prepaid Calling Card Services*, WC Docket No. 05-68, Declaratory Ruling and Report and Order, 21 FCC Rcd 7290 (2006) (*Prepaid Calling Card Order*).

[520] We use the term "IP/PSTN" as a shorthand, without reaching any universal conclusions regarding the technology underlying the PSTN. Today the PSTN continues to rely primarily on circuit-switched technology to connect to end-user customers, although we recognize that carriers increasingly are converting portions of their networks to IP technology. *See, e.g., IP-Enabled Services; E911 Requirements for IP-Enabled Service Providers*, WC Docket Nos. 04-36, 05-196, First Report and Order and Notice of Proposed Rulemaking, 20 FCC Rcd 10245, 10258, para. 24 & n.77 (2005) (distinguishing the "specialized" CPE required for interconnected VoIP services from the standard CPE used for typical telephone calls); *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Report to Congress, 13 FCC Rcd 11501, 11532, para. 84 (1998) ("'IP telephony' services enable real-time voice transmission using Internet protocols. The services can be provided in two basic ways: through software and hardware at customer premises, or through 'gateways' that enable applications originating and/or terminating on the PSTN. Gateways are computers that transform the circuit-switched voice signal into IP packets, and vice versa, and perform associated signaling, control, and address translation functions."). Insofar as a service allows a customer to originate a communication on an IP network and terminate it on a circuit-switched network, or vice versa, it involves a net

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today involves a net protocol conversion between end-users, and thus constitutes an "enhanced" or "information service."[521]

205. Although there are certain exceptions to this treatment, we do not find them applicable.[522] In particular, we do not find this to be "protocol conversion in connection with the introduction of new technology to implement existing services" that would be treated as a "basic," rather than "enhanced" service.[523] That exception was designed to address situations "involving no change in an existing service, but merely a change in electrical interface characteristics to facilitate transitional introduction of new technology."[524] By contrast, we find that IP/PSTN services are not mere changes to the underlying technology used for "existing" basic services, but are entirely new services with characteristics in many ways distinct from pre-existing telephone services.[525]

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protocol conversion, and we classify it as an "information service" today. Insofar as that service allows communications with no net protocol conversion, it is not subject to our "information service" classification here. We note that the presence of a net protocol conversion is not the only basis for classifying a service as an "enhanced" or "information service." *See, e.g.*, 47 C.F.R. § 64.702(a); *Computer II Final Decision*, 77 FCC 2d at 420–21, para. 97. We do not reach those issues at this time, however.

[521] *See, e.g.*, *Implementation of the Non-Accounting Safeguards of Sections 271 and 272 of the Communications Act of 1934, as Amended*, CC Docket No. 96-149, First Report and Order and Further Notice of Proposed Rulemaking, 11 FCC Rcd 21905, 21957–58, para. 106 (1996) (*Non-Accounting Safeguards Order*). Interpreting the 1996 Act's definition of "information services," the Commission held that "all of the services that the Commission has previously considered to be 'enhanced services' are 'information services.'" *Non-Accounting Safeguards Order*, 11 FCC Rcd at 21956, para. 103. For the all reasons discussed in Part V.B.2, we decline to defer the classification of IP/PSTN services, as requested by some parties, instead finding it appropriate to address this issue as part of our comprehensive reforms. *See, e.g.*, Letter from Ben Scott, Policy Director, Free Press, to Marlene H. Dortch, Secretary, FCC, WC Docket Nos. 05-337, 06-122, CC Docket Nos. 96-45, 01-92 at 15 (filed Oct. 24, 2008) (Free Press Oct. 24, 2008 *Ex Parte* Letter); Letter from Brad E. Mutschelknaus and Genevieve Morelli, Counsel for Broadview Networks, et al., to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92 at 2 (filed Oct. 28, 2008).

[522] Two of the exceptions are: (1) protocol processing involving communications between an end user and the network itself (e.g., for initiation, routing, and termination of calls) rather than between or among users; and (2) protocol conversion to facilitate the interconnection of networks. *Non-Accounting Safeguards Order*, 11 FCC Rcd at 21957–58, para. 106. These categories of protocol processing services may involve protocol conversions, but they result in no net protocol conversion between the end users. *Implementation of the Non-Accounting Safeguards of Sections 271 and 272 of the Communications Act of 1934, as Amended*, CC Docket No. 96-149, Order on Reconsideration, 12 FCC Rcd 2297, 2297–99, para. 2 (1997). Thus, they are not relevant here.

[523] *Amendment to Sections 64.702 of the Commission's Rules and Regulations (Third Computer Inquiry); and Policy and Rules Concerning Rates for Competitive Common Phase II Carrier Service and Facilities Authorization Thereof; Communications Protocols Under Section 64.702 of the Commission's Rules and Regulations*, CC Docket No. 85-229, Report and Order, 2 FCC Rcd 3072, 3081, para. 65 (1987) (*Computer III Phase II Order*). *See also Non-Accounting Safeguards Order*, 11 FCC Rcd at 21957–58, para. 106.

[524] *Communications Protocols under Section 64.702 of the Commission's Rules and Regulations*, GN Docket No. 80-756, Memorandum Opinion, Order, and Statement Of Principles, 95 FCC 2d 584, para. 16 (1983) (*Protocols Order*).

[525] *See, e.g.*, Letter from Donna Epps, Vice President, Federal Regulatory, Verizon, to Marlene H. Dortch, Secretary, FCC, WC Docket Nos. 04-36, 06-122, CC Docket No. 01-92, Attach. at 9–11 (filed Sept. 19, 2008); Letter from Susanne A. Guyer, Senior Vice President, Federal Regulatory Affairs, Verizon, to Chairman Kevin J. Martin, FCC, WC Docket No. 04-36, at 10–11 (filed Aug. 6, 2007); Letter from AT&T et al., to Chairman Kevin J. Martin, FCC, et al., WC Docket No. 04-36, CC Docket No. 01-92 at 2–3 (filed Aug. 6, 2008); VON Coalition *IP-Enabled Services NPRM* Comments at 3–16; AT&T *IP-Enabled Services NPRM* Comments at 13–17. We thus disagree with parties who suggest, in essence, that IP/PSTN services are no different than "basic" services. *See, e.g.*, Letter from
(continued....)

206. Consistent with the *Pulver.com Order* and the *Vonage Order*, we preempt any state efforts to impose "traditional 'telephone company' regulations" as they relate to IP/PSTN information services as inconsistent with our generally unregulated treatment of information services.[526] Of course, neither the *Vonage Order*, the *Pulver.com Order*, nor our actions here preempt state actions that are consistent with federal policy.[527] Moreover, as we describe below, we allow states to establish reciprocal compensation rates, pursuant to our methodology, including for IP/PSTN traffic.

207. In sections 251 and 252 of the Act, Congress altered the traditional regulatory framework based on jurisdiction by expanding the applicability of national rules to historically intrastate issues and state rules to historically interstate issues.[528] In the *Local Competition First Report and Order*, the Commission found that the 1996 Act created parallel jurisdiction for the Commission and the states over interstate and intrastate matters under sections 251 and 252.[529] The Commission and the states "are to address the same matters through their parallel jurisdiction over both interstate and intrastate matters under sections 251 and 252."[530] Moreover, section 251(i) provides that "[n]othing in this section shall be construed to limit or otherwise affect the Commission's authority under section 201."[531] The Commission concluded that section 251(i) "affirms that the Commission's preexisting authority under section 201 continues to apply for purely interstate activities."[532]

208. In implementing sections 251 and 252 in the *Local Competition First Report and Order*, the Commission's treatment of LEC-CMRS traffic provides an instructive approach. Prior to the 1996 Act, the Commission expressly preempted "state and local regulations of the kind of interconnection to which CMRS providers are entitled" based on its authority under section 201 and 332 of the Act.[533] Nevertheless, in the *Local Competition First Report and Order*, the Commission brought LEC-CMRS

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Thomas Jones and Jonathan Lechter, Counsel for tw telecom et al., to Marlene H Dortch, Secretary, FCC, CC Docket Nos. 01-92, 96-45, WC Docket Nos. 05-337, 99-68, 04-36, Attach. at 2 (filed Oct. 28, 2008) (tw telecom *et. al* Oct. 28, 2008 *Ex Parte* Letter). We note that whether a service is viewed by consumers as a possible substitute for a "basic" service is a distinct question from whether, as a matter of technology and the nature of the service offering, the service simply replaces the technology underlying a pre-existing basic service. Thus, our conclusion here is not inconsistent with the Commission's recognition that interconnected VoIP services increasingly are viewed by consumers as a substitute for traditional telephone services. *See, e.g.*, *LNP Order*, 22 FCC Rcd at 19547, para. 28.

[526] *Vonage Order*, 19 FCC Rcd at 22404; *see also Pulver.com Order*, 19 FCC Rcd at 3316, para. 15 ("We determine, consistent with our precedent regarding information services, that FWD is an unregulated information service and any state regulations that seek to treat FWD as a telecommunications service or otherwise subject it to public-utility type regulation would almost certainly pose a conflict with our policy of nonregulation.").

[527] For example, states are free to require contributions to state universal service or telecommunications relay service funds through methodologies that are consistent with federal policy. *See, e.g.*, Letter from Robert W. Quinn, Jr. Senior Vice President, Federal Regulatory, AT&T, to Chairman Kevin J. Martin, FCC, WC Docket Nos. 04-36, 06-122, CC Docket No. 96-45 at 11–16 (filed July 23, 2008) (describing ways that states could require contributions to state universal service or telecommunications relay service funds in a manner that is consistent with federal policy).

[528] *See Local Competition First Report and Order*, 11 FCC Rcd at 15544, para. 83.

[529] *Local Competition First Report and Order*, 11 FCC Rcd at 15544–45, para. 85.

[530] *Local Competition First Report and Order*, 11 FCC Rcd at 15546–47, para. 91.

[531] 47 U.S.C. § 251(i).

[532] *Local Competition First Report and Order*, 11 FCC Rcd at 15546–47, para. 91.

[533] *Implementation of Sections 3(n) and 332*, Second Report and Order, 9 FCC Rcd 1411, 1498, para. 230 (1994).

interconnection within the section 251 framework as it relates to intraMTA (including interstate intraMTA) traffic.[534] The Commission recognized, however, that it continued to retain separate authority over CMRS traffic.[535]

209. Courts confirmed that, in permitting LEC-CMRS interconnection to be addressed through the section 251 framework, the Commission did not in any way lose its independent jurisdiction or authority to regulate that traffic under other provisions of the Act. Thus, although the Eighth Circuit invalidated the Commission's TELRIC pricing rules in general,[536] it recognized that "because section 332(c)(1)(B) gives the FCC the authority to order LECs to interconnect with CMRS carriers, we believe that the Commission has the authority to issue the rules of special concern to the CMRS providers, [including the reciprocal compensation rules] but only as these provisions apply to CMRS providers. Thus, [the pricing] rules . . . remain in full force and effect with respect to the CMRS providers, and our order of vacation does not apply to them in the CMRS context."[537] Subsequently, the D.C. Circuit held that CMRS providers were entitled to pursue formal complaints under section 208 of the Act for violations of the Commission's reciprocal compensation rules.[538]

210. We build upon our actions in the *Local Competition First Report and Order*, and now permit states to establish a uniform reciprocal compensation rate, in accordance with the new methodology we establish in this order, pursuant to the section 251(b)(5) and 252(d)(2) framework. In particular, section 251(b)(5) imposes on all LECs a "duty to establish reciprocal compensation arrangements for the transport and termination of telecommunications."[539] Section 252(d)(2)(A) sets forth an "additional costs" standard that state commissions, in arbitrating interconnection disputes involving incumbent LECs, should apply in setting the "charges for transport and termination of traffic."[540] Although we allow states to set new uniform termination rates under this framework, pursuant to our methodology, we retain our authority under section 201 to find that reciprocal compensation charges are unjust and unreasonable as they relate to interstate, CMRS, and IP/PSTN traffic within our jurisdiction.[541] We expect that states will faithfully implement the pricing standards adopted in this order,

[534] *See Local Competition First Report and Order*, 11 FCC Rcd at 16005, para. 1023.

[535] *Local Competition First Report and Order*, 11 FCC Rcd at 16005, para. 1023 ("By opting to proceed under sections 251 and 252, we are not finding that section 332 jurisdiction over interconnection has been repealed by implication, or rejecting it as an alternative basis for jurisdiction.").

[536] We note that the Supreme Court later reversed this decision and affirmed the TELRIC methodology. *See Verizon v. FCC*, 535 U.S. at 467.

[537] *Iowa Utils. Bd. v. FCC*, 120 F.3d 753, 800 n.21 (8th Cir. 1997) (*Iowa Utils. I*), *rev'd in part and remanded on other grounds*, *AT&T v. Iowa Utils. Bd.*, 525 U.S. 366.

[538] *Qwest Corp. v. FCC*, 252 F.3d 462, 465–66 (D.C. Cir. 2001) (describing the Eighth Circuit's analysis of section 332(c)(1)(B) in *Iowa Utils. I* and concluding that an attempt to relitigate the issue was barred by the doctrine of issue preclusion).

[539] 47 U.S.C. § 251(b)(5).

[540] 47 U.S.C. § 252(d)(2)(A).

[541] *See supra* paras. 203–09. *See also, e.g.*, Letter from John T. Nakahata, Counsel for Level 3 Communications, to Marlene H. Dortch, Secretary, FCC, WC Docket No. 01-92 at 9–11 (filed on Aug. 18, 2008) (Level 3 Aug. 18, 2008 *Ex Parte* Letter). Contrary to Verizon's claims, we thus find no tension between permitting states to set reciprocal compensation rates for interstate traffic under the section 251 and 252 framework and the Commission's continuing authority over traffic subject to its jurisdiction, including section 201 authority expressly preserved under section 251(i).

and thus it will not be necessary for us to exercise that authority.[542]

211. The Commission unquestionably has authority to interpret and adopt rules implementing sections 251(b)(5) and 252(d)(2). Congress delegated to the Commission the task of administering the Communications Act. Section 201(b) authorizes the Commission to "prescribe such rules and regulations as may be necessary in the public interest to carry out the provisions of this Act."[543] "[T]he grant in § 201(b) means what it says: The FCC has rulemaking authority to carry out the 'provisions of this Act.'"[544] The Commission's rulemaking authority is not limited to interstate matters; it extends to all provisions of the Communications Act.[545]

212. In addition, we find that the section 251(b)(5) and 252(d)(2) framework is broad enough to facilitate our intercarrier compensation reform. We acknowledge that, in the *Local Competition First Report and Order*, the Commission found that section 251(b)(5) applies only to local traffic,"[546] and some commenters continue to press for such an interpretation.[547] As other commenters recognize, however, the Commission, in the *ISP Remand Order*, reconsidered that judgment and concluded that it was a mistake to read section 251(b)(5) as limited to local traffic, given that "local" is not a term used in section 251(b)(5).[548] We recognize, as the Supreme Court noted in *AT&T Corp. v. Iowa Utilities Board*, that "[i]t

[542] We recognize that "the just and reasonable rates required by Sections 201 and 202 . . . must ordinarily be cost-based, absent a clear explanation of the Commission's reasons for a departure from cost-based ratemaking." *Access Charge Reform*, CC Docket Nos. 96-262, 94-1, 91-213, Second Order on Reconsideration and Memorandum Opinion and *Order*, 12 FCC Rcd 16606, 16619–20, para. 44 (*Access Charge Reform Second Order*) (citing *Competitive Telecomms. Ass'n v. FCC*, 87 F.3d 522, 529 (D.C. Cir. 1996)). In this order, we adopt an incremental cost methodology for setting termination rates. We find that the proper application of that methodology produces rates that are "just and reasonable" under section 201. As discussed below, we find it appropriate to adopt a transition before carriers begin charging rates set pursuant to our incremental cost methodology.

[543] 47 U.S.C. § 201(b) ("The Commission may prescribe such rules and regulations as may be necessary in the public interest to carry out the provisions of this Act.").

[544] *AT&T v. Iowa Utils. Bd.*, 525 U.S. at 378.

[545] *AT&T v. Iowa Utils. Bd.*, 525 U.S. at 378 n.6 ("[T]he question in these cases is not whether the Federal Government has taken the regulation of local telecommunications competition away from the States. With regard to the matters addressed by the 1996 Act, it unquestionably has.").

[546] *Local Competition First Report and Order*, 11 FCC Rcd at 16012–13, para. 1033.

[547] *See, e.g.*, Verizon/Verizon Wireless Oct. 2, 2008 Supp. Comments at 24–32; Letter from Daniel Mitchell, Vice President, Legal and Industry, NTCA, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92 at 9 (filed Sept. 30, 2008) (NCTA Sept. 30, 2008 *Ex Parte* Letter); Verizon *ICC FNPRM* Comments at 38–42; NARUC *ICC FNPRM* Comments at 6–7; Rural Alliance *ICC FNPRM* Comments at 144–49; Cincinnati Bell *ICC FNPRM* Comments at 5–11; Maine PUC and Vermont Pub. Serv. Bd. *ICC FNPRM* Comments at 7; New York State PSC *ICC FNPRM* Comments at 7; Verizon and BellSouth, Supplemental White Paper on ISP Reciprocal Compensation, CC Docket No. 96-98, 99-68 at 16–20 (filed July 20, 2004) (Verizon/BellSouth Supp. ISP White Paper); NARUC's Initial Comments at 7 n.13 (May 23, 2004). *But see, e.g.*, ICF *ICC FNPRM* Comments at 39.

[548] *ISP Remand Order*, 16 FCC Rcd at 9166–67, para. 35. *See also, e.g.*, Qwest, Legal Authority for Comprehensive Intercarrier Compensation Reform at 2–4, *attached to* Letter from Melissa Newman, Counsel for Qwest, to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 01-92, 06-45, 99-68, WC Docket Nos. 04-36, 05-337, 05-195, 06-122 (filed Oct. 7, 2008); Letter from Kathleen O'Brien Ham et al., Counsel for T-Mobile, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92 at 9–10 (filed Oct. 3, 2008); Level 3 Aug. 18, 2008 *Ex Parte* Letter at 2, 15–18; AT&T *Missoula Phantom Traffic* Reply at 35–41; Brief from Gary M. Epstein, Counsel for ICF, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92 at 29–35 (filed Oct. 5, 2004)

would be a gross understatement to say that the 1996 Act is not a model of clarity."[549] Nevertheless, we find that the better view is that section 251(b)(5) is not limited to local traffic.

213. We begin by looking at the text of the statute. Section 251(b)(5) imposes on all LECs the "duty to establish reciprocal compensation arrangements for the transport and termination of telecommunications."[550] The Act broadly defines "telecommunications" as "the transmission, between or among points specified by the user, of information of the user's choosing, without change in the form or content of the information as sent and received."[551] Its scope is not limited geographically ("local," "intrastate," or "interstate") or to particular services ("telephone exchange service,"[552] telephone toll service,"[553] or "exchange access"[554]). We find that the traffic we elect to bring within this framework fits squarely within the meaning of "telecommunications."[555] Had Congress intended to preclude the Commission from bringing certain types of telecommunications traffic within the section 251(b)(5) framework, it could have easily done so by incorporating restrictive terms in section 251(b)(5). Because Congress used the term "telecommunications," the broadest of the statute's defined terms, we conclude that section 251(b)(5) is not limited only to the transport and termination of certain types of telecommunications traffic, such as local traffic.

214. In the *Local Competition First Report and Order* the Commission concluded that section 251(b)(5) applies only to local traffic, but recognized that "[u]ltimately . . . the rates that local carriers impose for the transport and termination of local traffic and for the transport and termination of long distance traffic should converge."[556] In the *ISP Remand Order*, the Commission reversed course on the scope of section 251(b)(5), finding that "the phrase 'local traffic' created unnecessary ambiguities, and we correct that mistake here."[557] The *ISP Remand Order* noted that "the term 'local,' not being a statutorily defined category, . . . is not a term used in section 251(b)(5)."[558] The Commission found that the scope of section 251(b)(5) is limited only by section 251(g), which temporarily grandfathered the pre-1996 Act rules governing "exchange access, information access, and exchange services for such access" provided to IXCs and information service providers until "explicitly superseded by regulations prescribed by the Commission."[559] On appeal, the D.C. Circuit left intact the Commission's findings concerning the scope

[549] *AT&T v. Iowa Utils. Bd.*, 525 U.S. at 397.

[550] 47 U.S.C. § 251(b)(5).

[551] 47 U.S.C. § 153(43).

[552] *Id.* at § 153(47).

[553] *Id.* at § 153(48).

[554] *Id.* at § 153(16).

[555] As discussed above, we classify IP/PSTN services as "information services." We note, however, that information services, by definition, are provided "via telecommunications," enabling us to bring IP/PSTN traffic within the section 251(b)(5) framework. 47 U.S.C. § 153(20). Moreover, given that we retain independent authority under section 201, we find it reasonably ancillary to that authority to regulate IP/PSTN services in this regard, consistent with our efforts to ensure uniform treatment of all traffic on the PSTN for intercarrier compensation purposes. Thus, IP/PSTN traffic ultimately will be subject to the final uniform reciprocal compensation rates established pursuant to the methodology adopted in this order. We maintain the status quo for this traffic during the transition, however.

[556] *Local Competition First Report and Order*, 11 FCC Rcd at 16012, para. 1033.

[557] *ISP Remand Order*, 16 FCC Rcd at 9173, para. 46.

[558] *ISP Remand Order*, 16 FCC Rcd at 9167, para. 34.

[559] 47 U.S.C. § 251(g).

of section 251(b)(5), although it took issue with other aspects of the *ISP Remand Order*.[560]

215. We agree with the finding in the *ISP Remand Order* that traffic encompassed by section 251(g) is excluded from section 251(b)(5) except to the extent that the Commission acts to bring that traffic within its scope. Section 251(g) preserved the pre-1996 Act regulatory regime that applies to access traffic, including rules governing "receipt of compensation."[561] There would have been no need for Congress to have preserved these compensation rules against the effects of section 251 if the scope of section 251(b)(5) was not broad enough for the Commission to bring within its scope the traffic covered by section 251(g), i.e., access traffic. Because Congress is presumed not to have wasted its breath, particularly with a provision as lengthy and detailed as section 251(g), we find that section 251(g) confirms that section 251(b)(5) applies to the transport and termination of all telecommunications traffic exchanged with LECs, including ISP-bound traffic. And because section 251(g) "is worded simply as a transitional device, preserving various LEC duties that antedated the 1996 Act until such time as the Commission should adopt new rules pursuant to the Act,"[562] we clearly have authority under the Act to adopt regulations superseding that regime. We exercise that authority today.[563]

216. By placing all traffic under the umbrella of one compensation scheme, we eliminate jurisdictional and regulatory distinctions that are not tied to economic or technical differences between services. As the Commission observed in the *Intercarrier Compensation NPRM*, regulatory arbitrage arises from different rates that different types of providers must pay for essentially the same functions.[564] Our current classifications require carriers to treat identical uses of the network differently, even though such disparate treatment usually has no economic or technical basis. These artificial distinctions distort the telecommunications markets at the expense of healthy competition. Similar types of traffic should be subject to similar rules. Similar types of functions should be subject to similar cost recovery mechanisms. We achieve that result by moving away from the regime preserved by section 251(g) and bringing that traffic within the section 251(b)(5) framework.

217. We disagree with commenters who argue that section 251(b)(5) only can be applied to traffic exchanged between LECs, and not traffic exchanged between a LEC and another carrier.[565] The

[560] *See WorldCom*, 288 F.3d at 429.

[561] 47 U.S.C. 251(g).

[562] *WorldCom*, 288 F.3d at 430.

[563] Verizon notes that although the Commission in the *ISP Remand* Order deleted the word "local" from its regulations governing reciprocal compensation, the regulations continued to exclude access services from the scope of section 251(b)(5). *See* Verizon/Verizon Wireless Oct. 2, 2008 Supp. Comments at 24–32; 47 C.F.R. § 51.701(b)(1). At that time, it made sense to retain the access exemption because the Commission had not issued rules superseding the access regime preserved by section 251(g). We supersede the grandfathered access regime in this order, at least in part.

[564] *Intercarrier Compensation NPRM*, 16 FCC Rcd at 9616, para. 12.

[565] *See, e.g.*, Verizon/Verizon Wireless Oct. 2, 2008 Supp. Comments ("The best interpretation of § 251(b)(5) – read in light of the text, structure, and history of the 1996 Act – is that the reciprocal compensation obligation applies only to intraexchange (or 'local') voice calls that originate on the network of one LEC (or wireless provider) and terminate on the network of another LEC (or wireless provider) operating in the same exchange (or, in the case of wireless providers, the same MTA."); Verizon and BellSouth, Internet-Bound Traffic is Not Compensable Under Sections 251(b)(5) and 252(d)(2) at 26 (Verizon/BellSouth ISP White Paper) ("By its nature, 'reciprocal compensation' must . . . apply to 'telecommunications' exchanged *between LECs* (or carriers, like CMRS providers, that the Commission is authorized to treat as LECs), not to traffic that is exchanged between LECs and non-LECs."), *attached to* Letter from Ann D. Berkowitz, Associate Director, Federal Regulatory Advocacy, Verizon, to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 99-68, 96-98 (filed May 17, 2004).

Commission rejected that argument in the *Local Competition Order*, finding that section 251(b)(5) applies to traffic exchanged by a LEC and any other telecommunications carrier, and adopted rules implementing that finding.[566] In a specific application of that principle, the Commission concluded that "CMRS providers will not be classified as LECs,"[567] but nevertheless found that "LECs are obligated, pursuant to section 251(b)(5) (and the corresponding pricing standards of section 252(d)(2)), to enter into reciprocal compensation agreements with all CMRS providers."[568] No one challenged that finding on appeal, and it has been settled law for the past 12 years. We see no reason to revisit that conclusion now. Although section 251(b)(5) indisputably imposes the duty to establish reciprocal compensation arrangements on LECs alone, Congress did not limit the class of potential beneficiaries of that obligation to LECs.[569]

218. We also disagree with commenters who argue that section 252(d)(2)(A)(i) limits the scope of section 251(b)(5).[570] Section 252(d)(2)(A)(i) provides that a state commission "shall not consider the terms and conditions for reciprocal compensation to be just and reasonable" unless "such terms and conditions provide for the mutual and reciprocal recovery by each carrier of costs associated with the transport and termination on each carrier's network facilities of calls that originate on the network facilities of the other carrier."[571] Verizon and others argue that this provision necessarily excludes interexchange traffic from the scope of section 251(b)(5) because at the time the 1996 Act was passed, calls neither originated nor terminated on an IXC's network.[572] We reject this reasoning because it erroneously assumes that Congress intended the pricing standards in section 252(d)(2) to limit the otherwise broad scope of section 251(b)(5). We do not believe that Congress intended the tail to wag the dog.

[566] *See Local Competition First Report and Order*, 11 FCC Rcd at 16013–16, paras. 1034–41. *See also* 47 C.F.R. 51.703(a) ("Each LEC shall establish reciprocal compensation arrangements for transport and termination of telecommunications traffic with any requesting telecommunications carrier."); *ISP Remand Order*, 16 FCC Rcd at 9193–94, para. 89 n.177 ("Section 251(b)(5) applies to telecommunications traffic between a LEC and a telecommunications carrier . . . .").

[567] *Local Competition First Report and Order*, 11 FCC Rcd at 15996, para. 1005. In this regard, we note that, absent a determination that CMRS providers are LECs, IXC-CMRS traffic would not be encompassed by section 251(b)(5), since neither are LECs. Nevertheless, it is our intention that, at the end of the transition, CMRS providers be entitled to reciprocal compensation for all the traffic they terminate. As the Commission has observed, "[t]here are three ways in which a carrier seeking to impose charges on another carrier can establish a duty to pay such charges: pursuant to (1) Commission rule; (2) tariff; or (3) contract." *Petitions of Sprint PCS and AT&T Corp. For Declaratory Ruling Regarding CMRS Access Charges, Declaratory Ruling*, 17 FCC Rcd 13192, 13196, para. 8 (2002).

[568] *Local Competition First Report and Order*, 11 FCC Rcd at 15997, para. 1008.

[569] If Congress had intended to limit the class of potential beneficiaries of LECs' duty to establish reciprocal obligation arrangements, it would have said so explicitly. *See* 47 U.S.C. § 251(b)(3) (describing the "duty to provide dialing parity to competing providers of telephone exchange service and telephone toll service").

[570] *See, e.g.*, Verizon/BellSouth ISP White Paper at 41–43; New York State PSC *ICC FNPRM* Comments at 8–9; TDS *ICC FNPRM* Comments at 19 n.27; Qwest *ICC FNPRM* Comments at 39; NASUCA *ICC FNPRM* Reply at 17–18.

[571] 47 U.S.C. § 252(d)(2)(A)(i).

[572] *See, e.g.*, Maine PUC and Vermont Pub. Serv. Bd. *ICC FNPRM* Comments at 7–8; New York State PSC *ICC FNPRM* Comments at 7–10; Verizon/BellSouth Supp. ISP White Paper at 16–20; NARUC *ICC FNPRM* Comments at 7 n.13.

219. Section 251(b)(5) defines the scope of traffic that is subject to reciprocal compensation. *Section 252(d)(2)(A)(i), in turn, deals with the mechanics of who owes what to whom, it does not define* the scope of traffic to which section 251(b)(5) applies. Section 252(d)(2)(A)(i) provides that, at a minimum, a reciprocal compensation arrangement must provide for the recovery by each carrier of costs associated with the transport and termination on each carrier's network of calls that originate on the network of the other carrier.[573] Section 252(d)(2)(A)(i) does not address what happens when carriers exchange traffic that originates or terminates on a third carrier's network. This does not mean, as Verizon suggests, that section 251(b)(5) must be read as limited to traffic involving only two carriers. Rather, it means that there is a gap in the pricing rules in section 252(d)(2), and the Commission has authority under section 201(b) to adopt rules to fill that gap.

220. We reject Verizon's argument that a telecommunications carrier that delivers traffic to an ISP is not eligible for reciprocal compensation because the carrier does not "terminate" telecommunications traffic at the ISP.[574] In the *Local Competition Order*, the Commission defined "termination" as "the switching of traffic that is subject to section 251(b)(5) at the terminating carrier's end office switch . . . and delivery of that traffic to the called party's premises."[575] As the D.C. Circuit suggested in the *Bell Atlantic* decision, "Calls to ISPs appear to fit this definition: the traffic is switched by the LEC whose customer is the ISP and then delivered to the ISP, which is clearly the 'called party.'"[576] We agree.[577] Consequently, ISP-bound traffic is subject to our new intercarrier compensation framework.[578]

221. We reject opponents' other arguments that the context and history of the 1996 Act compel a finding that section 251(b)(5) could not be applied to access traffic. Verizon argues, for example, that section 251(g) demonstrates that Congress did not intend to displace the existing access pricing regime.[579] This argument ignores that Congress preserved the access regime only "until such

[573] 47 U.S.C. § 252(d)(2)(A)(i).

[574] *See, e.g.*, Verizon/Verizon Wireless Oct. 2, 2008 Supp. Comments at 33–34; Verizon/BellSouth ISP White Paper at 31–32.

[575] *Local Competition First Report and Order*, 11 FCC Rcd at 16015, para. 1040. *See also* 47 C.F.R. § 51.701(d).

[576] 206 F.3d at 6.

[577] Because ISP-bound traffic did not fall within the section 251(g) carve out from section 251(b)(5) as "there had been *no* pre-Act obligation relating to intercarrier compensation for ISP-bound traffic," *WorldCom*, 288 F.3d at 433, ISP-bound traffic is, and always has been, subject to section 251(b)(5), although clearly interstate in nature and subject to our section 201 authority.

[578] We reject Verizon's argument against the application of section 251(b)(5) to ISP-bound traffic because this traffic is one-way traffic and as such is not reciprocal. *See* Verizon/Verizon Wireless Oct. 2, 2008 Supp. Comments at 26; Verizon/BellSouth ISP White Paper at 41–43. As Level 3 points out, these arguments have been rejected by the Commission and the U.S. Court of Appeals for the Ninth Circuit. *See* Level 3 Aug. 18, 2008 *Ex Parte* Letter at 18; *Pacific Bell v. Cook Telecom, Inc.*, 197 F.3d 1236, 1242–44 (9th Cir. 1999) (reciprocal compensation applies to paging traffic); *TSR Wireless, LLC v. U.S. West Commc'ns, Inc.*, 15 FCC Rcd 11166, 11178, para. 21 (2000) (the Commission's reciprocal compensation rules draw "no distinction between one-way and two-way carriers"). Because our conclusion in this order concerning the scope of section 251(b)(5) is no longer tied to whether this traffic is local or long distance, we need not address arguments made by the parties as to whether ISP-bound traffic constitutes "telephone exchange service" under the Act. *See, e.g.*, Letter from John T. Nakahata, Counsel for Level 3 Communications, LLC, to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 99-68, 96-98, Attach. at 1 (filed Sept. 24, 2004). We note, however, that we retain our interim ISP-bound traffic rules. *See supra* paras. 194–200.

[579] *See* Verizon *ICC FNPRM* Comments at 41.

restrictions and obligations are explicitly superseded by regulations prescribed by the Commission."[580] As noted above, we find that section 251(g) actually supports a finding that section 251(b)(5) is broad enough to cover access traffic. Verizon also argues that the reference to reciprocal compensation in the competitive checklist in section 271,[581] which was designed to ensure that local markets are open to competition, somehow shows that Congress intended to limit the scope of section 251(b)(5) to local traffic.[582] We do not see how this argument sheds any light on the scope of section 251(b)(5). Congress no doubt included the reference to reciprocal compensation in section 271 because section 251(b)(5) applies to local traffic, a point that no one disputes. That does not suggest, however, that section 251(b)(5) applies *only* to local traffic.

222. We need not respond to every other variation of the argument that the history and structure of the Act somehow demonstrate that section 251(b)(5) does not apply to access traffic. At best, these arguments show that one plausible interpretation of the statute is that section 251(b)(5) applies only to local traffic, a view that the Commission embraced in the *Local Competition First Report and Order*. These arguments do not persuade us, however, that this is the only plausible reading of the statute. Moreover, many of the same arguments based on the history and context of the adoption of section 251 to limit its scope to local traffic were rejected by the D.C. Circuit in the context of section 251(c).[583] We find that the better reading of the Act as a whole, in particular the broad language of section 251(b)(5) and the grandfather clause in section 251(g), supports our view that the transport and termination of all telecommunications exchanged with LECs is subject to the reciprocal compensation regime in sections 251(b)(5) and 252(d)(2).

223. The approach we adopt here provides a sound basis for comprehensive reform, and we thus decline to adopt alternative proposals. On one hand, we note that some commenters advocate that the Commission adopt an intercarrier compensation rate or cap of $0.0007 per minute of use for all traffic.[584] To implement this reform proposal, parties have suggested that it would likely be necessary for

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[580] 47 U.S.C. § 251(g).

[581] *See* 47 U.S.C. § 271(c)(2)(B)(xiii).

[582] *See* Verizon/Verizon Wireless Oct. 2, 2008 Supp. Comments at 26; Verizon/BellSouth ISP White Paper at 9.

[583] *United States Telecom Ass'n v. FCC*, 359 F.3d 554, 592 (D.C. Cir. 2004) (*USTA II*) ("Even under the deferential *Chevron* standard of review, an agency cannot, absent strong structural or contextual evidence, exclude from coverage certain items that clearly fall within the plain meaning of a statutory term. The argument that long distance services are not 'telecommunications services' has no support."). In *USTA II*, the D.C. Circuit was addressing whether the term "telecommunications services" was limited to local telecommunications services under section 251(c), while here we consider the analogous question of whether "telecommunications" is limited to local telecommunications under section 251(b).

[584] *See, e.g.*, Letter from Grace E. Koh, Policy Counsel, Cox Enterprises, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92, Attach. A at 1 (filed Oct. 6, 2008); Letter from Teresa D. Bauer and Richard R. Cameron, Counsel for Global Crossing North America, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92 at 1 (filed Sept. 18, 2008); Letter from Susanne A. Guyer, Senior Vice President of Federal Regulatory Affairs, Verizon, to Kevin Martin et al., Commissioners, FCC, CC Docket. 01-92 at 4 (filed Sept. 12, 2008) (Verizon Sept. 12, 2008 *Ex Parte* Letter). *But see, e.g.*, Letter from Richard A. Askoff, Executive Director—Regulatory, NECA, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92 at 3 (filed Oct. 7, 2008) ("Prescription of a nationwide uniform default rate of $0.0007 is unnecessary to solve the rate arbitrage problems identified by Verizon. It would also represent bad policy."); Letter from Lawrence Zawalick, Senior Vice President, Rural Telephone Finance Cooperative, to Kevin Martin et al., Commissioners, FCC, CC Docket 01-92 at 1 (filed Sept. 30, 2008) ("The Rural Telephone Finance Cooperative (RTFC) strongly opposes [the $0.0007] proposal.").

the Commission to preempt state regulation of intrastate access charges.[585] We believe that such a significant step is not currently warranted, and elect instead to allow states to continue setting rates for intrastate traffic, as well as permitting them to set rates for traffic subject to federal jurisdiction, pursuant to our methodology. We fully expect the new pricing methodology to achieve the goals of our continuing intercarrier compensation reform. On the other hand, some parties contend that the Commission should leave matters of intrastate intercarrier compensation reform entirely to the states.[586] These proposals evidence a pre-1996 Act worldview, however. Given the tools that the 1996 Act put at our disposal, we find it possible to move forward with truly comprehensive intercarrier compensation reform under an approach which still provides for a state role.

224. We note that, in the *Local Competition First Report and Order*, the Commission observed that section 251(b)(5) does not address charges payable to a carrier that originates traffic and concluded, therefore, that such charges were prohibited under that provision of the Act.[587] Because we elect to have the states set rates under section 251(b)(5), pursuant to our methodology, we find that retention of originating charges would be inconsistent with that statutory scheme and our new regulatory approach. Accordingly, we find that originating charges for all telecommunications traffic subject to our comprehensive intercarrier compensation framework must be eliminated at the conclusion of the transition to the new regime. We recognize, however, that changes to originating access charge rates may raise issues distinct from terminating charges. Moreover, several parties urge the Commission to delay any changes to originating charges.[588] For these reasons, we ask parties to comment on the appropriate transition for eliminating originating access charges in the accompanying Further Notice.[589] Although we ask parties to comment on the appropriate transition for eliminating originating access charges, we clarify that, under the transitional mechanism we adopt today, carriers are not permitted to increase any of their

[585] *See, e.g.*, Letter from Donna Epps, Vice President, Federal Regulatory, Verizon, to Marlene H. Dortch, Secretary, FCC, WC Docket Nos. 04-36, 06-122, CC Docket No. 01-92, Attach. at 14–25 (filed Sept. 19, 2008) (Verizon Sept. 19, 2008 *Ex Parte* Letter).

[586] In some cases, parties propose that the Commission make available universal service support as an "enticement" for states to reform intrastate rates, but ultimately the decisions would be left to the individual states. *See* Letter from Tom Karalis, Counsel for Rural Alliance, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92, Attach. at 7 (filed Sept. 26, 2008).

[587] *See Local Competition First Report and Order*, 11 FCC Rcd at 16016, para. 1042 *See also* 47 C.F.R. § 51.703(b) (stating that a "LEC may not assess charges on any other telecommunications carrier for telecommunications traffic that originates on the LEC's network").

[588] *See, e.g.*, Verizon Sept. 12, 2008 *Ex Parte* Letter at 5 (asking the Commission to defer reform of originating access); Letter from Grace E. Kohl, Policy Counsel, Cox, to Marlene H. Dortch, Secretary, FCC, WC Docket Nos. 06-122, 05-337, CC Docket Nos. 96-45, 01-92, 99-68, 96-262 at 2 (filed Oct. 6, 2008) (supporting proposals to delay reform of originating access) (Cox Oct. 6, 2008 *Ex Parte* Letter); Letter from Brian Benison, Director—Federal Regulatory, AT&T, to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 01-92, 99-68, 96-45, WC Docket Nos. 05-337, 07-135, Attach. at 3 (filed Oct. 7, 2008) (describing model with "No Change to Current Structure and Rates" for originating access); Letter from Kathleen O'Brien Ham, Federal Regulatory Affairs, T-Mobile, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92 at 5 (filed Oct. 3, 2008); *cf.* Letter from Mary C. Albert, Assistant General Counsel, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92, WC Docket Nos. 04-36, 05-337, Attach. at 1 (filed Oct. 2, 2008) (urging the Commission to delay any changes to intercarrier compensation). *But see* Letter from Anna M. Gomez, Vice President, Government Affairs, COMPTEL, to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 01-92, 96-45, WC Docket No. 04-36 at 7 (filed Oct. 1, 2008) (urging the Commission to reform originating access immediately) (Sprint Oct. 1, 2008 *Ex Parte* Letter).

[589] *See infra* para 343.

current rates, including their originating access rates.[590] Thus, both interstate and intrastate originating switched access rates will remain capped at current levels until further action by the Commission addressing the appropriate transition for this traffic. This approach is consistent with our transition of terminating rates[591] and with our goal of eliminating originating access charges at the conclusion of the transition to the new regime.

b. Legal Authority for the Transition

225. Although we comprehensively reform intercarrier compensation, we do not flash cut to our new regime, but provide for a measured transition.[592] The goal of this transition is to avoid overly rapid rate changes for consumers while providing carriers with sufficient means to preserve their financial integrity as we move to the new intercarrier compensation regime.[593] For many of the same reasons that we have authority to adopt comprehensive reform, we find that the Commission has clear authority to establish such a transitional structure to serve as a glide path to the new methodology we have developed in this order.

226. We find it reasonable to adopt a transition plan under these circumstances. As the D.C. Circuit has recognized, avoiding "market disruption pending broader reforms is, of course, a standard and accepted justification for a temporary rule,"[594] and here temporary rules setting forth a glide path are needed to mitigate potentially adverse rate or revenue effects that may be caused by our comprehensive intercarrier compensation reform, including the elimination of implicit universal service subsidies in those rates. Therefore, the Commission's exercise of its authority to create a transition plan is especially appropriate here, where the Commission is acting to reconcile the Act's "implicit tension between . . . moving toward cost-based rates and protecting universal service."[595] Not surprisingly, most commenters have affirmatively recognized the need for a transitional regime.[596] Indeed, every major plan submitted to

[590] This prohibition on increasing access rates also applies to the Primary Interexchange Carrier Charge in section 69.153 of the Commission's rules, the per-minute Carrier Common Line charge in section 69.154 of the Commission's rules, and the per-minute Residual Interconnection Charge in section 69.155 of the Commission's rules. 47 C.F.R. §§ 69.153, 69.154, 69.155.

[591] *See supra* para. 194 (prohibiting carriers from increasing their current rates, even if the interim, uniform reciprocal compensation rate is higher than one or more of its current rates).

[592] *See supra* section V.B.2.

[593] This approach is consistent with Commission precedent set forth in Part V.A, which started reforming intercarrier compensation in the 1980s. There the Commission found that a "transitional plan is necessary" in part because "[i]mmediate recovery of high fixed costs through flat end-user charges might cause a significant number of local exchange service subscribers to cancel local exchange service despite the existence of a Universal Service Fund" and "[s]uch a result would not be consistent with the goals of the Communications Act." *1983 Access Charge Order*, 93 FCC 2d at 243, para. 4. As a result, the Commission initially limited the flat rate charge imposed on end users, also known as the subscriber line charge or SLC, to $1.00 (subsequent orders raised the cap on the subscriber line charge for residential users to $6.50).

[594] *Competitive Telecomms. Ass'n v. FCC*, 309 F.3d 8, 14 (D.C. Cir. 2002).

[595] *Southwestern Bell Tel. Co. v. FCC*, 153 F.3d 523, 538 (8th Cir. 1998).

[596] *See, e.g.*, BellSouth *ICC FNPRM* Comments at 17 ("In order to avoid the market disruption and dislocation that would be associated with instantaneous implementation of a unified plan, BellSouth proposes a two-phase transition plan."); CCG *ICC FNPRM* Comments at 2 ("Any plan that reduces access rates should be phased-in over as long a period as possible, at least for rural carriers, so these companies have time to prepare for and adjust to the economic impact."); Cincinnati Bell *ICC FNPRM* Comments at 12 ("The Commission must allow carriers the opportunity to earn this lost access revenue in the transition to a new compensation regime in order to make any regime change

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us in this proceeding, whether the Missoula plan,[597] the ICF plan,[598] Verizon's plan,[599] AT&T's plan,[600] or the plan from CBICC,[601] ARIC,[602] NARUC,[603] or NASUCA,[604] has called for the Commission to establish an orderly transition period. We take heed of these commenters and of our statutory responsibilities to ensure a smooth transition to the new regime by setting forth a multi-stage transition plan as part of our comprehensive reform of intercarrier compensation.

227. Moreover, we have several independent sources of legal authority to adopt the transition plan established in this order. For one, section 251 explicitly contemplates our authority to adopt a transitional scheme with regard to access charges. We agree with the United States Court of Appeals for the District of Columbia Circuit that section 251(g) created a "transitional enforcement mechanism"[605] preserving the access charge regimes that pre-dated the 1996 Act "until . . . explicitly superseded by regulations *prescribed by the Commission*."[606] Thus, section 251(g), by its terms, anticipates that the Commission may take action to end the regimes grandfathered by section 251(g), and inherent within the power to supersede the grandfathered access regime is the lesser power to prescribe regulations that determine *how* to transition to a cost-based pricing mechanism—a power that we have twice employed in

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revenue neutral to the affected carriers."); CCAP *ICC FNPRM* Comments at 23 ("The CCAP believes that any reform of the existing intercarrier compensation regimes should take place over a three-to-five-year period . . . .").

[597] Missoula Plan, Executive Summary at 3 ("Recognizing the vast differences among carriers, the Plan creates three different transition schedules for intercarrier compensation rates.").

[598] Letter from Gary M. Epstein and Richard R. Cameron, Counsel for ICF, to Marlene H. Dortch, Secretary, FCC, CC Docket 01-92, Attach. 2 at 3 (filed Aug. 16, 2004).

[599] Verizon Sept. 12, 2008 *Ex Parte* Letter at 9–10.

[600] Letter from Henry Hultquist, Federal Regulatory Vice-President, AT&T, to Marlene H. Dortch, Secretary, FCC, CC Docket 01-92, Attach 1 at 4 (filed July 17, 2008).

[601] Letter from Richard M. Rindler, Counsel for CBICC, to Marlene H. Dortch, Secretary, FCC, CC Docket 01-92, Attach. 1 at 2.

[602] ARIC *ICC FNPRM* Comments, Attach. 1 at 33.

[603] NARUC *ICC FNPRM* Comments, Attach. C at 6.

[604] Letter from Philip F. McClelland, Senior Assistant Consumer Advocate, NASUCA, to Marlene H. Dortch, Secretary, FCC, CC Docket 01-92, Attach. 1 at 1 (filed Dec. 14, 2004).

[605] *WorldCom*, 288 F.3d at 433.

[606] 47 U.S.C. § 251(g) (emphasis added). At the least, section 251(g) preserved the interstate access regime the Commission had prescribed for all carriers (*see id.* (preserving "obligations (including receipt of compensation) . . . under any . . . regulation, order, or policy of the Commission . . . .")) and the intrastate access regime the Bell Operating Companies had agreed to in the Modified Final Judgment. *See United States v. AT&T*, 552 F. Supp. at 169. Recognizing, however, that it would be "'incongruous to conclude that Congress was concerned about the effects of potential disruption to the interstate access charge system, but had no such concerns about the effects on analogous intrastate mechanisms,'" the Commission has consistently interpreted section 251(g) to preserve the intrastate access regime pre-dating the Act for all carriers. *ISP Remand Order*, 16 FCC Rcd at 9168 n.66 (quoting *Local Competition First Report and Order*, 11 FCC Rcd at 15869, para. 732); *see also Competitive Telecomms. Ass'n v. FCC*, 117 F.3d 1068, 1072 (8th Cir. 1997) ("[I]t is clear from the Act that Congress did not intend all access charges to move to cost-based pricing, at least not immediately. The Act plainly preserves certain rate regimes already in place.").

the past to reduce access charges without explicitly superseding that regime.[607]

228. In addition, as the Supreme Court has further held, the Commission has authority to prescribe the requisite pricing methodology that the States will apply in setting rates under section 252(d)(2).[608] Consistent with our authority, the Commission here is providing for a transitional regime in the public interest to smooth the transition to the new pricing standard adopted by this order. The goal of this transition is to allow gradual changes to consumer rates while providing carriers with sufficient means to preserve their financial integrity as we move to the new intercarrier compensation regime.

229. Significantly, as discussed in greater detail above, although we elect to rely on the sections 251(b)(5) and 252(d)(2) framework for reform, that does not affect the Commission's jurisdiction over traffic or services otherwise subject to federal authority.[609] With respect to interstate services, the Act has long provided us with the authority to establish just and reasonable "charges, practices, classifications, and regulations."[610] The Commission also has authority over the rates of CMRS providers pursuant to section 332 of the Act.[611] The Commission thus retains full authority to adopt transition plans for traffic and services subject to federal jurisdiction, even when it is within the sections 251(b)(5) and 252(d)(2) framework. Because we re-affirm our findings concerning the interstate nature of ISP-bound traffic, it follows that such traffic falls under the Commission's section 201 authority preserved by the Act.[612] This conclusion is reinforced by section 251(i) of the Act. As the Commission explained in the

[607] *See MAG Order*, 16 FCC Rcd 19613 (reducing interstate access charges for rate-of-return carriers); *CALLS Order*, 15 FCC Rcd 12962 (reducing interstate access charges for price-cap carriers), *aff'd in relevant part by Texas Office of Pub. Util. Counsel v. FCC*, 265 F.3d at 324 (reasoning that because the Commission had not yet superseded the pre-Act interstate access regime, it retained authority under section 201(b) to set just and reasonable rates for interstate access); *see also WorldCom*, 288 F.3d at 433 ("We will assume without deciding that under § 251(g) the Commission might modify LECs' pre-Act 'restrictions' or 'obligations,' pending full implementation of relevant sections of the Act. The Fifth Circuit appeared to make that assumption . . . .").

[608] *AT&T v. Iowa Utils. Bd.*, 525 U.S. at 384; *see also id.* at 378 ("The FCC has rulemaking authority to carry out the 'provisions of this Act,' which include §§ 251 and 252, added by the Telecommunications Act of 1996.")

[609] *See supra* para. 207.

[610] 47 U.S.C. § 201(b).

[611] 47 U.S.C. § 332.

[612] We have consistently found that ISP-bound traffic is jurisdictionally interstate. ISP-bound traffic melds a traditional circuit-switched local telephone call over the PSTN to packet switched IP-based Internet communication to Web sites. *Declaratory Ruling*, 14 FCC Rcd at 3702, para. 18; *ISP Remand Order*, 16 FCC Rcd at 9175, para. 52. This conclusion has not been questioned by the D.C. Circuit. *See WorldCom*, 288 F.3d at 431; *Bell Atlantic v. FCC*, 206 F.3d at 5 ("There is no dispute that the Commission has historically been justified in relying on this method when determining whether a particular communication is jurisdictionally interstate"). In other contexts, the Commission has likewise found that services that offer access to the Internet are jurisdictionally interstate services. In 1998, for example, the Commission found that ADSL service is jurisdictionally interstate. *See GTE Tel. Operating Cos.*, CC Docket No. 98-79, Memorandum Opinion and Order, 13 FCC Rcd 22466, 22481, para. 28 (1998) ("finding that GTE's ADSL service is subject to federal jurisdiction" and is "an interstate service"). More recently, the Commission has confirmed this ruling for a variety of broadband Internet access services. *See Inquiry Concerning High-Speed Access to the Internet Over Cable and Other Facilities*, GN Docket No. 00-185, CS Docket No. 02-52, Declaratory Ruling and Notice of Proposed Rulemaking, 17 FCC Rcd 4798, 4832, para. 59 (2002) (finding that, "on an end-to-end analysis," "cable modem service is an interstate information service"); *Wireline Broadband Internet Access Order*, 20 FCC Rcd at 14914, para. 110, *aff'd by Nat'l Cable & Telecomms. Ass'n v. Brand X Internet Servs. (Brand X)*, 545 U.S. 967 (2005); *Appropriate Regulatory Treatment for Broadband Access to the Internet Over Wireless Networks*, WT 07-53, Declaratory Ruling, 22 FCC Rcd 5901, 5911, para. 28 (2007); *United Power Line Council's Petition for Declaratory Ruling Regarding the Classification of Broadband over*

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ISP Remand Order, section 251(i) "expressly affirms the Commission's role in an evolving telecommunications marketplace, in which Congress anticipates that the Commission will continue to develop appropriate pricing and compensation mechanisms for traffic that falls within the purview of section 201."[613] It concluded that section 251(i), together with section 201, equips the Commission with the tools necessary to keep pace with regulatory developments and new technologies.[614] When read together, these statutory sections preserve the Commission's authority to address new issues that fall within its section 201 authority over interstate traffic, including compensation for the exchange of ISP-bound traffic. Consequently, in the *ISP Remand Order*, the Commission properly exercised its authority under section 201(b) to issue interim pricing rules governing the payment of compensation between carriers for ISP-bound traffic.[615]

230. This result is consistent with the D.C. Circuit's opinion in *Bell Atlantic*, which concluded that the jurisdictional nature of traffic is not dispositive of whether reciprocal compensation is owed under section 251(b)(5).[616] It is also consistent with the court's *WorldCom* decision, in which the court rejected the Commission's view that section 251(g) excluded ISP-bound traffic from the scope of section 251(b)(5), but made no other findings.[617] Finally, this result does not run afoul of the Eighth Circuit's decision on remand from the Supreme Court in the *Iowa Utilities Board* litigation, which held that "the FCC does not have the authority to set the actual prices for the state commissions to use" under section 251(b)(5).[618] At the time of that decision, under the *Local Competition First Report and Order*, section 251(b)(5) applied only to local traffic. Thus, the Eighth Circuit merely held that the Commission could not set reciprocal compensation rates for local traffic. The court did not address the Commission's authority to set reciprocal compensation rates for interstate traffic.[619] In sum, the Commission plainly has authority to establish pricing rules for interstate traffic, including ISP-bound traffic, under section 201(b), and that authority was preserved by section 251(i).

4. Additional Costs Standard

231. We now turn to reconsideration of our "additional costs" standard for implementing section 252(d)(2). Before describing our new standard, we briefly review the relevant statutory language

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Power Line Internet Access Service as an Information Service, WC 06-10, Memorandum Opinion and Order, 21 FCC Rcd 13281, 13288, para. 11 (2006). In the *Vonage Order*, the Commission likewise found that VoIP services are jurisdictionally interstate, employing the same end-to-end analysis reflected in those other orders. *Vonage Order*, 19 FCC Rcd at 22413–14, paras. 17–18.

[613] *ISP Remand Order*, 16 FCC Rcd at 9174, para. 50.

[614] *See ISP Remand Order*, at 9175, para. 51.

[615] We thus respond to the D.C. Circuit's remand order in *WorldCom*, 288 F.3d at 434, and the court's writ of mandamus in *Core Communications*, 531 F.3d at 861–62, which directed the Commission to explain its legal authority to issue the interim pricing rules for ISP-bound traffic adopted in the *ISP Remand Order*. Specifically, we find, for the reasons set forth above and in Part V.B.3, that the Commission had the authority to adopt the interim pricing regime pursuant to our broad authority under section 201(b) to issue rules governing interstate traffic.

[616] *See Bell Atlantic*, 206 F.3d at 5.

[617] *See WorldCom*, 288 F.3d at 434.

[618] *Iowa Utils. Bd. v. FCC*, 219 F.3d 744, 757 (8th Cir. 2000) (*Iowa Utils. II*), *rev'd in part sub nom. Verizon v. FCC*, 535 U.S. 467.

[619] Indeed, as discussed above, the court expressly confirmed the Commission's independent authority to set rates for CMRS traffic pursuant to section 332 and declined to vacate the Commission's pricing rules as they applied in the context of CMRS service. *See supra* para. 214; *Iowa Utils. I*, 120 F.3d at 800 n.21.

and the Commission's implementation of the "additional costs" standard in the *Local Competition First Report and Order*. We then explain the importance of incremental cost in regulated pricing. Next we examine the incremental cost of call termination on modern networks. Finally we describe in detail the "additional costs" standard we adopt in this order.

a. Background

232. Section 252(d)(2)(A) sets forth the standard that state commissions, in arbitrating interconnection disputes, should apply in setting the "charges for transport and termination of traffic." That section states that "[f]or the purposes of compliance ... with section 251(b)(5), a State commission shall not consider the terms and conditions for reciprocal compensation to be just and reasonable unless (i) such terms and conditions provide for the mutual and reciprocal recovery by each carrier of costs associated with the transport and termination on each carrier's network facilities of calls that originate on the network facilities of the other carrier; and (ii) such terms and conditions determine such costs on the basis of a reasonable approximation of the additional costs of terminating such calls."[620] Section 252(d)(2)(B) provides that the preceding standard "shall not be construed (i) to preclude arrangements that afford the mutual recovery of costs through offsetting of reciprocal obligations, including arrangements that waive mutual recover (such as bill and keep arrangements); or (ii) to authorize the Commission or any State commission to engage in any rate regulation proceedings to establish with particularity the additional costs of transporting or terminating calls, or to require carriers to maintain records with respect to the additional costs of such calls."[621]

233. In the *Local Competition First Report and Order*, the Commission adopted implementing rules interpreting section 252's pricing standards for interconnection and UNEs (section 252(d)(1)), and for reciprocal compensation (section 252(d)(2)). In setting the pricing methodology for interconnection and UNEs, the Commission directed the states to employ a forward-looking, long-run average incremental cost methodology, known as TELRIC.[622] The TELRIC methodology assumes that the relevant increment of output is all current and reasonably projected future demand, (i.e., it is designed to calculate the total cost of building a new, efficient network).[623] The Commission found that TELRIC rates should also include a reasonable allocation of forward-looking common costs, including overhead costs. Thus, TELRIC calculates the long-run average incremental cost of a network element. In setting the pricing methodology for reciprocal compensation, the Commission concluded that the statutory pricing standards for interconnection and UNEs (section 252(d)(1)), and for transport and termination of traffic (section 252(d)(2)), were "sufficiently similar" to permit the use of the same TELRIC methodology for establishing rates under both statutory provisions.[624]

[620] 47 U.S.C. § 252(d)(2)(A).

[621] 47 U.S.C. § 252(d)(2)(B).

[622] *Local Competition First Report and Order*, 11 FCC Rcd at 15515, 15844–96, paras. 29, 672–732.

[623] *Local Competition First Report and Order*, 11 FCC Rcd at 15850–57, paras. 690–703, *see also* 47 C.F.R. § 51.505.

[624] *Local Competition First Report and Order*, 11 FCC Rcd at 16023, para. 1054. In applying the TELRIC methodology to reciprocal compensation, the Commission found that the "additional costs" to the LEC of terminating a call that originates on another carrier's network "primarily consists of the traffic-sensitive component of local switching." For purposes of setting rates, the Commission concluded that "only that portion of the forward-looking, economic cost of end-office switching that is recovered on a usage-sensitive basis constitutes an 'additional cost' to be recovered through termination charges." *Id.* at 16024–25, para. 1057. The Commission excluded non-traffic sensitive costs, such as the costs of local loops and line ports. *Id.* Further, the Commission concluded that termination rates established pursuant to the TELRIC methodology should include a reasonable allocation of

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234. Market developments since the adoption of the *Local Competition First Report and Order* demonstrate that application of the TELRIC methodology to reciprocal compensation has led to "excessively high reciprocal compensation rates."[625] More specifically, following the Commission's order, certain carriers began designing business plans to take advantage of above-cost reciprocal compensation payments by becoming a net recipient of local traffic. The most prevalent example of regulatory arbitrage for reciprocal compensation is ISP-bound traffic where the Commission found evidence that "CLECs appear to have targeted customers that primarily or solely receive traffic, particularly ISPs, in order to become net recipients" of reciprocal compensation payments.[626] As a result, the Commission has found that reciprocal compensation rates "do not simply compensate the terminating network, but also appear to generate profits for each minute that is terminated, thus creating a potential windfall."[627] In short, the evidence indicates that application of the TELRIC methodology to reciprocal compensation has not led to rates that accurately reflect a carrier's "additional costs" as the Commission initially envisioned and Congress intended. Rather, the Commission's existing pricing standard has led to rates that not only vary significantly among states,[628] but are generally too high, and which ultimately create regulatory arbitrage opportunities. Based on this evidence, and as detailed further below, we therefore conclude that we need to revise the current reciprocal compensation pricing methodology to align our standard more closely with the statutory text and with economic theory to eliminate, as far as possible, opportunities for regulatory arbitrage.

b. The Importance of Incremental Cost In Regulated Pricing

235. To provide a framework for our reconsideration of the proper "additional costs" methodology, we begin with a brief overview of long-standing principles for public utility pricing. As explained below, we believe the traditional economic definition of incremental cost, as applied to multiproduct firms, is most appropriate for setting intercarrier compensation rates. The Commission's existing TELRIC standard governing reciprocal compensation deviates from this more efficient version of

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forward-looking common costs because, the Commission reasoned, a rate equal to incremental costs may not compensate carriers fully when common costs are present. *Id.* at 16025, para. 1058. For transport, the Commission required the calling party's LEC to compensate the called party's LEC for the "additional costs" associated with transporting a call subject to section 251(b)(5) from the carriers' interconnection point to the called party's end office and for the additional costs of terminating the call to the called party. *Id.* at 16008–58, paras. 1027–118; see also 47 C.F.R. §§ 51.701(c), (d).

[625] *ISP* Remand Order, 16 FCC Rcd at 9185, para. 75); see also Letter from Norina Moy, Director, Government Affairs, Sprint Nextel, to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92, WC Docket No. 04-36 (filed Sept. 26, 2008) (Sprint Nextel Sept. 26, 2008 Ex Parte Letter).

[626] *Intercarrier Compensation NPRM*, 16 FCC Rcd at 9616, para. 11.

[627] *See, e.g., Intercarrier Compensation NPRM*, 16 FCC Rcd at 9616, para. 11; *see also Intercarrier Compensation FNPRM*, 20 FCC Rcd at 4698 n.67 ("[R]eciprocal compensation rates often substantially exceed the per-minute incremental cost of terminating a call and therefore create a potential windfall for carriers that serve customers that primarily or exclusively receive traffic."); *ISP Remand Order*, 16 FCC Rcd at 9192, para. 87 ("[T]here may be a considerable margin between current reciprocal compensation rates and the actual costs of transport and termination."); BellSouth *ICC* NPRM Comments at 9 ("[R]eciprocal compensation payments enabled carriers to offer services to their customers at rates that bore little relationship to actual costs and provided the recipients of reciprocal compensation an advantage over their competitors."); Verizon *2000 Remand of ISP Declaratory Ruling Public Notice* Comments at 11–12 (noting that competitive LECs with ISP customers reap a "windfall profit" because of high reciprocal compensation rates).

[628] *See, e.g.,* Eastern Rural Telecom Ass'n *ICC FNPRM* Comments at 2–3 ("Depending on the assumptions used to develop a company's TELRIC study, the results can vary significantly and be open to challenge.").

incremental cost, and is likely to lead to rates that significantly exceed efficient levels. We also consider evidence in the record concerning costs of switches and fiber.

236. In economic theory generally and in its application to regulation, the relationship of price and marginal cost is of fundamental importance. Marginal cost can be simply defined as the rate of change in total cost when output changes by an infinitesimal unit. In economics, the term incremental cost refers to a discrete change in total cost when output changes by any non-infinitesimal amount, which might range from a single unit to a large increment representing a firm's entire output.[629] The terms additional costs and avoidable costs are commonly used to refer to incremental costs resulting from an increase or a decrease in output respectively.[630]

237. In a competitive market, it is assumed that both consumers and producers independently will choose outputs to purchase or to supply on the basis of a market price. In standard economic analysis, this price is determined by the intersection of a downward sloping demand function, which represents consumer valuations for additional units of consumption, and an upward sloping supply function, which represents the marginal cost of supplying an additional unit. The competitive price is efficient in the following sense. At any other price, consumer demands would no longer be equal to producer supply, and market transactions would be limited to the smaller of the two terms.[631] At this level of output, consumers would value an additional unit of output more than the cost of producing it as determined by the marginal cost function. Hence both consumers and producers could be made better off by increasing output by a small amount.[632] When price is equal to the competitive price, no alternative price can be found such that both consumer and producers are better off.

238. *Forward-looking versus Historical Cost:* When prices are determined in a regulated market, similar reasoning applies. In this context, there is a large amount of literature on practical rules and procedures that must be considered to achieve an outcome that is as close as possible to a fully efficient one.[633] The cost of any economic resource is equal to its value in the best alternative use. The cost which a regulated firm incurs in producing a particular output is therefore equal to the value of the economic resources that are used to produce it, and which are therefore no longer available for the production of alternative goods and services. It follows that from the standpoint of economic efficiency,

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[629] If $C(q)$ represents the cost of producing an output q and Δq represents an increment of output, then incremental cost is equal to $C(q+\Delta q) - C(q)$. If incremental cost is used as a guide to pricing, then price should be set equal to the average incremental cost $\frac{C(q+\Delta q)-C(q)}{\Delta q}$. If there are no fixed costs and initial output $q = 0$, then incremental cost pricing is equivalent to average cost pricing. If Δq is small, then incremental cost pricing approximates marginal cost pricing. *Cf. Local Competition First Report and Order*, 11 FCC Rcd at 15844, para. 675.

[630] 1 KAHN, THE ECONOMICS OF REGULATION at 65–66. *See also* PRINCIPLES OF PUBLIC UTILITY RATES at 393.

[631] If price is greater than the competitive level, consumer demand is less than supply, and demand would determine market volume. If price is less than the competitive level, then producers voluntarily would supply no more than the amount at which marginal cost is equal to price.

[632] Where the market price exceeds marginal cost, there will be an associated deadweight loss in social welfare. The deadweight loss represents the loss in consumer plus producer surplus caused by a deviation from the competitive equilibrium. *See, e.g.*, DENNIS W. CARLTON & JEFFREY M. PERLOFF, MODERN INDUSTRIAL ORGANIZATION 84 (1990); KENNETH E. TRAIN, OPTIMAL REGULATION 185 (1992) (OPTIMAL REGULATION).

[633] *See, e.g.*, Ronald. H. Coase, *The Theory of Public Utility Pricing and Its Applications*, 1 BELL J. ECON. 113, 113–128 (1970) (*Theory of Public Utility Pricing*); 1 KAHN, THE ECONOMICS OF REGULATION at 63–86.

the only costs that are relevant in pricing decisions of a regulated firm are current or future costs, and that historical costs can be ignored.[634] We acknowledge that economists and industry experts have often debated the relative merits of forward-looking (or reproduction) cost versus historical (or original) capital cost in administering rate-of-return regulation,[635] and that regulators, including state regulators and this Commission, have continued to use historical cost in rate setting for smaller, primarily rural telephone companies. Nevertheless, since the adoption of the *Local Competition First Report and Order,* the Commission has consistently concluded that it believes that forward-looking costs are the most appropriate measure of cost.[636] In this order, we reaffirm our conclusion that forward-looking costs should form the basis for regulation in a uniform intercarrier compensation regime.

239. *Short-Run versus Long-Run Incremental Cost:* Economists have also debated whether it is appropriate to use short-run or long-run incremental cost as a guide for regulatory pricing.[637] Short-run incremental cost refers to the cost of an increment of demand when some inputs to production are in fixed supply. Long-run incremental cost refers to the cost of an increment when all inputs are variable. In order to set prices so as to maximize economic efficiency at any particular point in time, it is clear that short-run incremental cost is the appropriate concept.[638] For example, if an airline carrier has empty seats for a particular scheduled flight, then it would make sense to sell capacity for those seats at any price that would recover the small additional costs of fuel and amenities for an additional passenger. Pricing based on short-run incremental cost, however, necessarily implies that prices can be adjusted freely and perhaps continuously during the day.[639] Moreover, in a regulatory context, such flexibility is likely infeasible.

240. Short- or intermediate-run costs might also be advocated on practical grounds, since some productive inputs (e.g., poles and conduits) can have extremely long lives. Nevertheless, regulators have traditionally relied on long-run incremental costs rather than short-run incremental costs in setting regulated prices. First, setting prices on the basis of short-run incremental cost may mean that a carrier would not recover its average total cost of investment over the life of the asset.[640] Second, to the extent that forward-looking costs are used, long-run incremental costs are more naturally and easily accommodated, since a forward looking cost study can legitimately assume that all inputs are variable. In the *Local Competition First Report and Order*, the Commission, in adopting its TELRIC methodology, explained that "[t]his 'long run' approach ensures that rates recover not only the operating costs that vary in the short run, but also the fixed investment costs that, while not variable in the short term, are necessary inputs directly attributable to providing the element."[641] We reaffirm here the Commission's decision in the *Local Competition First Report and Order* that long-run incremental cost rather than short-run

[634] *Theory of Public Utility Pricing*, 1 BELL J. ECON. at 122; Alexander C. Larson, *An Economic Guide to Competitive Standards in Telecommunications Regulation*, 1 COMMLAW CONSPECTUS 31, 47 n.100 (1993) (quoting *Theory of Public Utility Pricing*, 1 BELL J. ECON. at 121–22).

[635] *See, e.g.*, 1 KAHN, THE ECONOMICS OF REGULATION at 109–16.

[636] *Local Competition First Report and Order*, 11 FCC Rcd at 15813, 15846, paras. 620, 679.

[637] *See* 1 KAHN, THE ECONOMICS OF REGULATION at 70–75, 83–103; *see also* PHILLIPS, THE ECONOMICS OF REGULATION at 390–91 (rev. ed. 1969); PRINCIPLES OF PUBLIC UTILITY RATES at 417–25.

[638] 1 KAHN, THE ECONOMICS OF REGULATION at 71; DANIEL F. SPULBER, REGULATION AND MARKETS 234 (1989) (REGULATION AND MARKETS).

[639] 1 KAHN, THE ECONOMICS OF REGULATION at 84.

[640] 1 KAHN, THE ECONOMICS OF REGULATION at 88.

[641] *Local Competition First Report and Order*, 11 FCC Rcd at 15851, para. 692.

incremental cost is the appropriate cost concept.[642]

241. *Peak Load Pricing*: Closely related to the question of short-run versus long-run costing is the issue of peak load pricing. When demand varies systematically by time of day, day of the week, or over longer periods, there may be periods of time when there is significant excess capacity, since productive inputs clearly cannot vary with such frequency. In such cases, economic efficiency might require that prices should vary by time or day or over longer periods even in the long run.[643] For example, many wireless telephone carriers offer free minutes of usage during weekends or evenings. Although these arguments are indisputable, it has proven difficult in practice to incorporate peak load pricing principles into regulated rate proceedings.[644] Accordingly, we conclude, as the Commission did in the *Local Competition First Report and Order*, that we should not require peak-load pricing as part of an intercarrier compensation regime, although we affirm that carriers should be free to voluntarily negotiate agreements including peak pricing principles.

242. *Common Costs*: Telecommunications carriers are multiproduct firms which provide a large array of services to different groups of consumers. Within the category of traditional telephony, these services include call origination, call termination, local transport, and either access to long distance transport or long distance service through an affiliated carrier. As networks evolve, the number of services that a telecommunications network can provide is rapidly expanding to include Internet access and other data services and, in some cases, video distribution. Many of these services share common facilities.[645] For example, a copper loop can be used to provide analog voice service as well as data service using DSL technology. The cost of the loop is therefore common to both voice and DSL services. The incremental cost of voice service, assuming that DSL is already provided, therefore does not include any of the long run incremental cost of the loop itself. Similarly, the incremental cost of DSL, assuming voice is already provided, includes only that portion of the loop cost that may be required to condition the loop to meet the higher quality standards that may be required for data transmission.

243. *Methodology for Computing Incremental Cost in Multiproduct Firms:* Common cost and its relationship to incremental cost in multiproduct firms can be more precisely defined as follows using an analysis developed by Faulhaber, Baumol, and others.[646] Under this approach, one imagines a multiproduct firm in which a forward looking cost function is known, which allows one to compute the "stand alone cost" of any possible subset of products. For example, if the set of products is indexed by the set $N = \{1, \ldots, n\}$, then the stand alone cost of the entire firm can be represented by the value $C(N)$. The incremental cost of any individual product j contained in N can then be represented by the value $IC(j) = C(N) - C(N - j)$, where $C(N - j)$ represents the stand alone cost of producing every product in the set N

[642] *Local Competition First Report and Order*, 11 FCC Rcd at 16023, para. 1054.

[643] 1 KAHN, THE ECONOMICS OF REGULATION at 89.

[644] *See Local Competition First Report and Order* at 15878, paras. 755–57. *See also* 1 KAHN, THE ECONOMICS OF REGULATION at 91–93.

[645] *Cf. Local Competition First Report and Order*, 11 FCC Rcd at 15845, para. 676 ("The term 'common costs' refers to costs that are incurred in connection with the production of multiple products or services, and remains unchanged as the relative proportion of those products or services varies (e.g., the salaries of corporate managers).").

[646] *See, e.g.*, Gerald R. Faulhaber, *Cross-Subsidization: Pricing in Public Enterprises*, 65 AM. ECON. REV. 966, 966–77 (1975). Faulhaber's objective in the paper was to define a test for cross subsidy, which could precisely define the maximum and minimum prices that a regulated firm should be allowed to charge to any subset of customers; WILLIAM J. BAUMOL ET AL., CONTESTABLE MARKETS AND THE THEORY OF INDUSTRY STRUCTURE 351–56 (1982); William J. Baumol, *Minimum and Maximum Pricing Principles for Residual Regulation, in Current Issues in* PUBLIC UTILITY ECONOMICS (A. Danielson & D. Kamerschen eds., 1983).

except product j. Under this definition, the incremental cost may be viewed as the *additional costs* of adding product j to a firm currently producing products (N – j). Alternatively, it may be viewed as the cost that may be *avoided* if the firm, currently producing products 1 through n, decides not to produce product j. The common cost for the firm as a whole is then equal to $C(N)-\sum_{j\in N} IC(j)$. When there is significant sharing of facilities used in providing groups of services to customers, common costs are typically positive, and may be a significant portion of the firm's total cost.

244. *Multiproduct Incremental Cost versus TELRIC:* In the *Local Competition First Report and Order*, the Commission adopted a pricing methodology, which it called Total Element Long Run Incremental Cost or TELRIC. Under the TELRIC methodology, prices for UNEs and interconnection would be determined by estimating the forward-looking cost of individual network elements, which the Commission defined as "physical facilities of the network, together with the features, functions, and capabilities associated with those facilities."[647] In adopting the TELRIC methodology, the Commission determined that forward-looking costs should be "based on the least cost, most efficient network ... technology," assuming current wire center locations.[648] It further determined that the relevant increment should "be the entire quantity of the network element provided."[649] The Commission concluded that "forward-looking common costs shall be allocated among elements and services in a reasonable manner ... ."[650] In choosing to estimate the forward-looking cost of the entire network element, the Commission acknowledged that, when a requesting carrier leased access to that element, it would have exclusive control over that element.[651]

245. With respect to reciprocal compensation, the Commission determined that "the 'additional cost' of terminating a call ... primarily consists of the traffic-sensitive component of local switching."[652] Nevertheless, the only non traffic-sensitive cost of the local switch that the Commission required states to exclude was the cost of line ports.[653] Similarly, in the rules that the Commission adopted regarding "shared transmission facilities between tandem switches and end offices," the Commission allowed the full forward-looking cost of those facilities to be recovered through usage sensitive charges.[654] Thus, with the exception of requiring recovery of the cost of line ports through flat-rated charges, the Commission's TELRIC rules permitted the full forward-looking cost of the local switch, tandem switch, and shared interoffice transmission facilities, including a reasonable allocation of common costs, to be recovered through usage-based charges. In effect, the Commission's TELRIC methodology permitted average-cost pricing using a forward-looking cost methodology.

246. The TELRIC methodology thus differs significantly from the definition of incremental cost for multiproduct firms proposed by Faulhaber and others. First, unlike TELRIC, the traditional

[647] *Local Competition First Report and Order*, 11 FCC Rcd at 15631, para. 258.

[648] *Local Competition First Report and Order*, 11 FCC Rcd at 15848–49, paras. 683–85.

[649] *Local Competition First Report and Order*, 11 FCC Rcd at 15850, para. 690.

[650] *Local Competition First Report and Order*, 11 FCC Rcd at 15852–53, para. 696.

[651] *Local Competition First Report and Order*, 11 FCC Rcd at 15693, para. 385.

[652] *Local Competition First Report and Order*, 11 FCC Rcd at 16025, para. 1057.

[653] *Local Competition First Report and Order*, 11 FCC Rcd at 16025, para. 1057. *Cf.* 47 U.S.C. § 51.509(b) (requiring only that line port costs of the unbundled local switching element be recovered through a flat-rated charge).

[654] 47 U.S.C. § 51.509(d).

economic approach for determining the incremental cost of a single service excludes all common costs. Second, although the TELRIC methodology is essentially an average cost methodology, the traditional economic approach focuses on identifying the additional forward-looking cost that a network would incur if it provided an additional service—in this case call termination. Under the traditional economic definition, the incremental cost of call termination would be determined by estimating the stand alone cost of a network which incorporates all existing services except call termination (including call origination, switching, etc.) and then subtracting this amount from a comparable estimate of the total cost of providing all the same existing services, including call termination. As should be obvious, the incremental cost of call termination under the traditional economic definition should be significantly lower than that calculated under a TELRIC methodology.

247. *The Relevance of Multi-part Pricing:* One common criticism of incremental cost pricing is that it may not permit a firm to recover its total costs, particularly if there are significant common costs.[655] Economists have pointed out, however, that multi-part pricing regimes can potentially lead to more efficient outcomes than uniform prices set equal to either marginal cost or average cost.[656] For example, if the firm is able to charge a fixed monthly fee and a variable usage charge, then it is possible for the firm to set the usage charge at or close to marginal cost and recover any residual costs through the fixed charge. In this case, the regulator must take account of both subscription and usage elasticities in order to minimize the possibility that higher fixed fees will cause some subscribers to drop off the network.[657] We note that, in the access charge regime, the Commission recognized the efficiencies associated with multi-part pricing, even if it failed to reduce usage-based charges to marginal or incremental cost.

c. The Incremental Cost of Call Termination on Modern Networks

248. We now consider the evidence in the record concerning the incremental cost of terminating calls on modern telecommunications networks. We note at the outset that there appear to be no cost studies or analyses in the record that attempt to estimate the termination costs using Faulhaber's definition of incremental cost. Thus, we would expect the cost estimates in the record to be significantly lower if they had been calculated using Faulhaber's definition.

249. We consider first evidence concerning the cost of termination on modern circuit switches. We note that, in 1996, when the Commission adopted the TELRIC methodology, circuit switches and fiber optic transmission facilities were generally considered the "least-cost, most efficient" currently available technology. And it appears that state commissions in interconnection arbitrations analyzed the forward-looking costs of circuit switches and fiber optic transmission facilities in developing TELRIC rates. Sprint Nextel filed an *ex parte* in which it analyzed state UNE rates for unbundled switching and common transport.[658] Sprint Nextel reports that the national weighted average price per minute for unbundled local switching was $0.00058 (with individual rates ranging from a low of $0.00004 to a high

[655] *See, e.g.*, REGULATION AND MARKETS at 122–23.

[656] *See, e.g., Theory of Public Utility Pricing*, 1 BELL J. ECON. at 117–20; OPTIMAL REGULATION at 191–213.

[657] Demand for subscription is generally estimated to be significantly less elastic than demand for usage. *See* Mercatus Center Sept. 22, 2008 *Ex Parte* Letter at 3 n.15; Jerry Hausman & Howard Shelanski, *Economic Welfare and Telecommunications Regulation: The E-Rate Policy for Universal-Service Subsidies*, 16 YALE J. ON REG. 19, 39 (1999) (estimating elasticity of demand for subscription to be -.005, whereas elasticity of demand for long-distance service is closer to -0.7); *Effects of Breakup of AT&T*, 83 AM. ECON. REV. at 182 (estimating elasticity of demand for basic access at -0.005 and elasticity of demand for long-distances service between -0.25 and -1.2).

[658] *See* Sprint Nextel Sept. 26, 2008 *Ex Parte* Letter. The data used in the analysis were obtained from the March 2006 "Survey of Unbundled Network Element Prices in the United States."